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PILOT Agreements- Critical Points

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PILOT Agreements Critical Points

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Experience

- 30+ Years experience in Forensic Accounting, Economic Damages and Valuations and Expert testimony:
 - Certified Public Accountant
 - Public School Accountant
 - Certified in Financial Forensic
 - Accredited in Business Valuation
 - Chartered Global Management Accountant
 - Member- New Jersey State Board of Accountancy
 - Court approved expert
 - Mayor- Borough of Watchung 2019-2022
 - Appearances- Dateline NBC, News 12, NJN, CN8

Areas in Need of Redevelopment

1) The tax abatement programs in New Jersey began in 1961. Beginning in the late 1950s, commercial and manufacturing employers in large New Jersey cities began an exodus from the cities, not only taking with them thousands of jobs but substantially eroding the city's tax base.

2) Newark, along with all major cities in New Jersey, needed a way to retain its large employment and tax base and to replace those businesses that had already either left or were in the process of relocating outside the city. The answer was the Fox-Lance Act. The Act encouraged developers to either redevelop or rehabilitate properties primarily in blighted areas.

3) As a means of ensuring continued development within New Jersey's cities, the Fox-Lance formula was generous to the entity (developer) but in reality may have been financially unfair to the cities.

4) The Long Term Tax Exemption Act N.J.S.A.40A:20-1 (1991), together with subsequent amendments, attempted not only to remedy the unintentional inequity imposed on the city by the initial Act, but also provided a more detailed governing law relative to financial controls governing tax abatements.



Areas in Need of Redevelopment



5) The developer benefits by receiving a property tax exemption on the improvements. In lieu of this the developer pays an annual service charge- PILOT payment pursuant to a negotiated agreement between the developer and the municipality.

6) Historically the PILOTs enticed a developer to take a large risk redeveloping property in the blighted cities.

7) As the population, business and economy of New Jersey has changed since the 1960s there brings into question whether an area is truly in need of redevelopment.

8) Criteria of an area in need of redevelopment are buildings that are substandard, unsafe, unsanitary, dilapidated or are not conducive for living or working.

9) The general purpose is to encourage and assist in redevelopment with goals and objectives of the community.

Areas in Need of Redevelopment-Jersey City



Areas in Need of Redevelopment-Jersey City



Areas in Need of Redevelopment-Newark



Areas in Need of Redevelopment-Success



Areas in Need of Redevelopment-Success



Areas in Need of Redevelopment-Success



Areas in Need of Redevelopment or NOT



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Areas in Need of Redevelopment or NOT



Areas in Need of Redevelopment or NOT



Areas in Need of Redevelopment or NOT

- Compliance with NJ Supreme Court case regarding Municipalities requirement to zone and create “Fair Share” of affordable housing for low and moderate income families
- Providing protections for the Municipalities against builders remedy law suits
- Encouraging and assisting in redevelopment with goals and objectives of the community is very broad far reaching in what a Municipality can do
- Municipal resident groups now pushing to control the direction of affordable housing developments in various communities



Financial Agreement

Key terms

- 1) Entities- Developer Urban Renewal entity and Government entity
- 2) Number of units and affordable units
- 3) Allowable Profit rate
- 4) Definition of annual gross revenue and examples

* Some developers structure a master lease with an affiliated entity to artificially lower the revenue of the PILOT entity. The master lease affiliated entity then collects the higher rents from all of the actual tenants and the developer builds up additional profits in its affiliate by underpaying the percentage under the PILOT based on the artificially lower revenue paid by the affiliate.

* Some Developers structure the operations with a lower base rent and separately invoice tenants for reimbursed expenses. The developer, then based on the definitions in the agreement for rent, exclude the reimbursed expenses from revenue to underpay the PILOT.



Financial Agreement

Key terms

- Jersey City project reviewed 19 of 179 PILOTs and identified areas for increased revenues for the City where property owners worked around PILOT terms to pay less to the City.
- 19 properties represented over \$1.0 billion in real estate value and were paying \$39 million per year under PILOTs versus \$80 million if they were paying regular tax



Financial Agreement

Key terms

- Newark project review revealed PILOT property had a master lease at below market rent and paid PILOT on that rent. However, the master lease was with related party that leased the space to the actual occupants at a substantially higher rent
- 53% of the entities sampled failed to have the required annual audit reports submitted which violated State statute; municipal ordinance; the financial agreement and authorizing municipal council resolution
- Outside auditors should be contracted to audit PILOT compliance
- Financial Agreements should be reviewed by third party consultants to identify loopholes



Financial Agreement

Key terms

- 5) Definition of annual service charges which are all negotiated recommend include examples of calculation
- 6) Annual audit report and required schedules and support
- 7) Definition of Net Profit and examples
- 8) Definition of Project Costs



Financial Agreement

Key terms

- 9) Duration of agreement
- 10) Recommend a minimum threshold as % of real estate taxes otherwise due on land & improvements
- 11) Recommend Entity pay both the annual service charge and the land tax payment
- 12) Annual service charges paid quarterly
- 13) Reporting and Audits required and consequences for breach
- 14) Limitations on Profits & Reserves



Financial Agreement

Key terms

- **ISSUES RAISED IN COMPLIANCE REVIEWS**
- Some Developers set up management agreements with affiliates to overpay expenses for management and maintenance of the property to artificially lower the profits of the PILOT entity to underpay the Municipality.
- Some Developers comingle expenses of multiple projects to overstate expenses of the PILOT entity thereby lowering profits and underpaying the Municipality.
- The Municipality can negotiate and put in the financial agreement what additional support and schedules it requires for the annual reporting and audit to ensure compliance.
- The Municipality can require annual inspections of units and fees for annual inspection and inspection every time a unit changes over.



Financial Projections and key financial factors

Estimated Project Costs and Estimated Construction Costs

- *Land & Land Improvements
- *Architects, Engineers and professionals
- *Projected Construction Costs
- *Insurance, Interest and Finance costs
- *Permanent Financing costs
- *Marketing
- *Real estate taxes
- *Developers Overhead



Financial Projections and key financial factors

Projected Construction Costs-Need Evaluation

- Challenge the amounts the developer is using for construction costs for each category.
- Compare costs to industry standards in your area
- Developers will typically overstate the estimated construction costs. Keep in mind they want to pay the least in taxes and the PILOT
- Developers will overstate costs to then also overstate the required debt
- Developers will understate the projected number of children to attend schools to minimize the cost impact on schools



Financial Projections and key financial factors



Financial Forecasts and Projected Rental Income and Expenses

- Developers will seek to understate the rental income for monthly tenant rents. Research and compare rents for new units in a similar location.
- Perform a comparison using the expected rental income and the multiple buyers are using to value acquisitions and then apply the municipal tax rate as a barometer for a potential tax floor
- Developers will overstate vacancies to lower the rent projections, check to industry statistics and community.
- Developers will overstate operating expenses to show a lower projected profit. Check to your area and statistics.
- Developers will overstate interest and debt and then understating rental income they seek to keep the PILOT payment at a low percentage of rent so they make the most profit.

Financial Projections and key financial factors

Financial Forecasts and Projected Rental Income and Expenses

- Municipalities need to challenge the projections and challenge the construction costs and debt costs
- Municipalities should research and find support for increasing the rental income and then establish that the developer will make more profit to be able to pay a higher PILOT % of rent to the municipality
- Developers will understate the affordable units rental income



Financial Impact on Schools and Municipal Resources

Financial Impacts and Negotiations

Developers typically use the Rutgers Study of School –Age Children in Rental Units in New Jersey and the Demographic Multipliers from the study

Key findings

- The number of school age children increases with the number of bedrooms
- number of school age children decrease as renters income rises



Financial Impact on Schools and Municipal Resources

Financial Impacts and Negotiations

- For challenging the impact on schools, use the fully loaded costs for additional students based on the entire school budget and not just the margin cost of one student to a classroom with solely educational costs.
- Developers underestimate the expected impact on the schools with additional children. Gather the facts from the schools regarding increased attendance using other developments in the area to use real data for your location to challenge the developers blanket use of an old studies.



Financial Impact on Schools and Municipal Resources

Financial Impacts and Negotiations

EXAMPLE For 230 apartments the developer projected 26 children to attend the schools. For the municipality we used the actual students that came from a similar 360 unit complex over the past 20 years and applied the percentage and projected 89 children. We also used the fully loaded cost of the entire school budget per pupil of \$22,000 per year versus the developer using \$9,600 per year. Having the actual facts enabled better negotiations for the municipality

- Developers will also understate the projected fair market value upon completion for assessment at regular tax when arguing their case. Consider a minimum threshold amount as a percentage of full tax assessment on the final value of the project to include in the agreement. Research support for value of new units for comparable assessments and work your tax assessor



Financial Impact on Schools and Municipal Resources

Municipal Resources and considerations

- Traffic issues and Traffic study and roadway grading. Challenge the professionals and provide feedback and debate over traffic on quality of life and safety
- Negotiate to provide pedestrian sidewalks and bike lanes for recreation and safety
- Installation of traffic light and road widening and turn lanes for safety and movement
- Responsibility for costs to upgrade roads and traffic lights and maintenance costs
- Lowering of speed limits for safety and cooperation from Counties



Financial Impact on Schools and Municipal Resources

- Consider the environmental impacts and challenge professionals and hire qualified professionals to rebut the developer's experts and challenge NJ DEP as well
- Developer's environmental study will minimize the impact to many species
- Question threatened and endangered species of animals; the developer professionals will state that the site is not suitable for those species that have lived on the site for hundreds of years and still live and thrive there
- Question Lot coverage and Flood plain and storm water issues with flooding



Financial Impact on Schools and Municipal Resources

- Thoroughly evaluate the adequacy of sewer capacity and how sewerage will be handled and paid for
- Evaluate the impact on emergency services and need to pass on costs for fire, EMS and additional police
- Consider the proximity to mass transit for affordable housing units regarding the property location
- Always apply sound planning for community growth and development



Audit and Monitoring of Compliance

- Add to the financial agreement the consequences of noncompliance with terms including the annual audit report and the schedules desired by the municipality
- Contract outside auditors to review compliance with terms and payments
- Tax assessor and tax collector should coordinate to have control over annual reporting and quarterly PILOT payments



Audit and Monitoring of Compliance

- PILOT agreements have terms for comparison phase-in as a percentage of the conventional tax on full assessed value. The municipality needs to use the fully assessed value for the land and improvements.
- In operational reviews we have seen errors where the improvement value was not included, and the project owners underpaid the amounts based on a percentage of the fully assessed value which only included the land value as compared to a percentage of gross revenues

